REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

HUNT-UNIVERSAL ROBINA CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5168

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUL 01 1998

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DECISION

Before Us is a judicial claim for refund/tax credit of alleged overpaid withholding taxes on royalties made by the petitioner in the amount of P4,471,863.90 during the period October, 1992 to September, 1993.

Petitioner, a domestic corporation duly organized and existing under the laws of the Republic of the Philippines, has an existing Trademark Licensing Agreement and Technical Assistance Agreement with Beatrice/Hunt Wesson, Inc., otherwise known as Hunt Wesson Foods International, Ltd. ("HWF" for brevity)[1], whereby the latter granted in favor of the former the sole and exclusive license to manufacture and sell products[2] in the Philippines in accordance with its formulas and specifications. HWF, likewise, undertakes to render technical assistance covering all technological aspects of production of its products[3] as well as in the

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[1] a non-resident corporation organized and existing under the laws of the State of Delaware, United States of America

[2] tomato-based products, fruit and vegetable juices, cooking and salad oil

development of new food products for export and sale within the Philippines. In return, petitioner is obligated to pay HWF a royalty fee of 1% of its net wholesale sales. The agreements were accordingly registered with and approved by the Technology Transfer Board of the Department of Trade and Industry.

In a letter, dated October 7, 1994, and filed with the Appellate Division of respondent's Bureau on October 10, 1994 (Exhibit "T"), petitioner claimed for a tax credit/refund of the aforesaid amount. It invoked this Court's decision in the case of **IBM Philippines, Inc. vs The Commissioner of Internal Revenue**, CTA Case No. 4308, promulgated on March 31, 1993, in arguing that on account of the 10% tax rate on royalties provided under the R.P. - West Germany Tax Treaty, the 25% tax rate on royalties as prescribed under Revenue Memorandum Order (RMC) No. 39-92 was erroneous, because the R.P. - U.S. Tax Treaty under Article 13(2)(b)(iii) thereof provides for the application of a most favored nation clause which assures the lowest rate of Philippine tax to royalties derived by a U.S. resident in case such rate is accorded to royalties paid to a resident of a Third State.

Events would show, however, that petitioner did not await any longer the action to be taken by the respondent

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[3] pork and beans, baked beans, tomato sauce, spaghetti sauce and ketchup

in view allegedly of the near expiry of the two-year period from date of payment of the tax within which a taxpayer may institute a claim for refund with this Court. Hence this appeal filed on October 28, 1994.

At bar, petitioner reiterated its stance *a quo*. In answer, respondent contended by way of affirmative and special defenses that in an action for refund, the taxpayer has the burden of showing that the taxes paid were erroneously or illegally collected and the failure to do so is fatal to the action; that claims for tax refund are strictly construed against the taxpayer; and that taxpayer-petitioner has no cause of action.

Based on the above facts and assertions of the parties, We are confronted with the following issues:

> 1 Whether or not the 10% withholding tax provided in Article 12(2)(b) of the R.P - West Germany Tax Treaty is applicable to licensing agreements covered by the R.P - U.S. Tax Treaty; and if in the affirmative,
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> 2 Whether or not petitioner has proven the factual elements of its claim for refund/tax credit.

After a painstaking scrutiny of the legal milieu of herein claim for refund, We note that this is not a case of first impression. In the light of our previous decisions in similar cases involving identical issues wherein We concurred with The Bureau of Internal Revenue

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in its BIR Ruling No. 456-88 that a 10% tax rate shall be imposed on royalties derived by a resident of the United States from sources within the Philippines, pursuant to the most favored nation provision of the RP-US Tax Treaty (Article 12(b)(iii) in relation to Article 12(2)(b) of the RP-West Germany Tax Treaty, We hereby rule peremptorily in favor of the petitioner. **(Abbot Laboratories, (Philippines) vs. Commissioner of Internal Revenue, CTA Case No. 5119, September 9, 1996, (Entry of Judgment, October 2, 1996); S.C. Johnson and Son, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 1996, (CA Affirmed our decision, November 7, 1996); Armco Marsteel Alloy Corporation, CTA Case No. 5115, February 6, 1996 (Entry of Judgment, February 28, 1996); Gillette (Philippines), Inc. vs. Commissioner of Internal Revenue, CTA Case No 4248, February 8, 1995, (Entry of Judgment, March 1, 1995); SmithKline and French Overseas Company vs. Commissioner of Internal Revenue, CTA Case No. 5048, September 22, 1995, (Entry of Judgment, January 30, 1996); Hunt Universal Robina Ccorporation vs. The Commissioner of Internal Revenue, CTA Case No. 4247, August 5, 1994, (On appeal-CA); IBM Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308, March 31, 1993, (Entry of Judgment, January 17, 1994); Kimberly-Clark Corporation (U.S.A) and**

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Kimberly-Clark (Philippines), Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4288, January 30, 1992, (CA Entry of Judgment, September 27, 1994); and General Electric Philippines Meter and Instrument Co., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4158, December 5, 1991 (CA Entry of Judgment, January 26, 1995).

Expounding further on the issue this Court deems it appropriate to cite hereunder the pertinent portion of our latest decision in the case of **Purina Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5286, promulgated on October 17, 1997.** Thus:

> Quoted hereunder is the pertinent portion of our decision in the case of ***IBM Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 4308, supra***:
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> > "On the second issue, whether or not petitioner should be taxed at the reduced rate of 10% withholding tax on royalties in accordance with Article 12(2)(b) of the RP-West Germany Tax Treaty and not 25% withholding tax on royalties under Article 13(2)(b)(111) of the RP-US Tax Treaty.
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> > This Court is of the persuasion that petitioner's stand is correct and concurs with the opinion rendered by the then Commissioner of Internal Revenue, Bienvenido Tan, Jr (BIR Ruling No. 456-88, *supra*), that under the most favored nation provision of the RP-US Tax Treaty (Article 13, paragraph 2(b)(iii), the tax

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> imposable on royalties derived by a resident of the United States from sources within the Philippines shall be the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state. Article 12, paragraph 2(b) of the RP-West Germany Tax Treaty, provides that royalties arising in the Philippines and paid to a resident of West Germany may also be taxed in the Philippines, but the tax so charged shall not exceed 10% of the gross amount of royalties Said treaty also provides that for as long as the transfer of technology under Philippine law, is subject to approval, the limitation of the tax rate in case of royalties arising in the Philippines, apply if the contract giving rise to such royalties has been approved by Philippine competent authorities."

Anent respondent's argument that the US licensors are in fact and in law not entitled to the lower tax rate of 10% on royalties derived from sources within the Philippines due to the absence of a 20% matching credit available under Art. 24(b) and (c)(iii) of the R.P. - West Germany Tax Treaty, the same had likewise been resolved by this Court in the aforementioned IBM Case (CTA Resolution, July 21, 1993) and again in the more recent case of ***BASF Coatings and Inks Philippines, Inc., CTA Case No. 5135, October 1, 1996*** to quote:

> "It is claimed by the respondent that this Court erred in granting the refund since petitioner is not entitled to the 'most favored tax rate on royalties' (Motion, CTA Records, p 345)
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> The applicable provision of the R.P. - U.S. Tax Treaty provides:
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> > "Art 13(2)(b)(iii). xxx (T)he tax imposed by

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> that other Contracting State shall not exceed the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state"(Underscoring supplied)

Respondent advanced his argument on the premise that the R.P - Germany Tax Treaty, which provides for a 10% tax on royalties does not apply in the case under consideration. He argued that:

"Under the xxx provisions of the German Tax Treaty, there is a 'matching credit' in Germany of 15% and 20%. A perusal of Article 23 (Relief from Double Taxation of the R.P. - U.S. Tax Treaty), there is no such tax credit so that the IBM WORLD TRADE CORPORATION AND INTERNATIONAL BUSINESS MACHINES CORPORATION are not entitled to the 'most favored nation' tax rate on royalties (10%) because their payment of the tax is not under similar circumstances i.e., there is 'matching credit' in Germany (20% for royalties), while there is no such credit in the U.S. xxx" (Motion, C.T.A. Records, p. 348)

Quoted below is the pertinent provisions of the R.P. - Germany Tax Treaty which reads:

"Article 24

Relief from Double Taxation

"1. Tax shall be determined in the case of a resident of the Federal Republic of Germany as follows:

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xxx xxx xxx

b) Subject to the provisions of German tax laws regarding credit for foreign tax, there shall be allowed as a credit against German income and corporate tax payable in respect of the following items of income arising in the Republic of the Philippines, the tax paid under the laws of the Philippines and in accordance with this Agreement on:

xxx xxx xxx

dd) royalties, as defined in paragraph 3 of Article 12;

c) For purpose of credit referred to in subparagraph (b), the Philippine Tax shall be deemed to be:

xxx xxx xxx

(iii) in the case of royalties for which the tax is reduced to 10% or 15% according to paragraph 2 of Article 12, 20% of the gross amount of such royalties."

To settle once and for all the legal issue involved in this case, this Court deems it wise to decide on the proper interpretation of the phrase "paid under similar circumstances". Does the phrase refer to tax paid as claimed by respondent or does it refer to royalties paid as advanced by petitioner?

A cursory perusal of the provision makes this Court to agree with the petitioner's interpretation. The phrase "paid under similar circumstances" is followed by the phrase "to a resident of a third state" It is clear that what is paid to a resident of a third state is royalty and not tax.

Petitioner succinctly put in its "Opposition to Motion for Reconsideration" that:

"Respondent is in effect amending the provision of the R.P - U.S. tax treaty. Article 13(2)(b)(iii) speaks of 'royalties of the same kind paid under similar circumstances to a resident of a third state'. Respondent is reading into the R.P. - U.S. tax treaty something that is not clearly not there.

The requirement of 'similar circumstances' is in relation to the payment of royalty, not payment of the tax. Thus, for instance, the royalty in question paid to a U.S. resident by petitioner (which is neither BOI-registered enterprise nor engaged in a preferred-pioneer activity) is not paid under similar circumstances as a royalty paid to an Austrian resident by a Philippine company that is BOI-registered and engaged in a preferred-pioneer activity. Also, a royalty paid to a resident of Denmark or Sweden in respect of motion picture films and tapes is not paid under similar circumstances as the royalty herein paid by petitioner to its U.S. licensors. Clearly, the phrase 'similar circumstances' is used in reference to the payment of the royalty, and not in reference to the payment of tax." (Opposition, C.T.A. Records, pp 363-364)

Finally, the Court of Appeals affirmed Our position in the IBM case in Commissioner of Internal Revenue vs. Philippine Tire and Rubber Corporation CA-G.R. SP No. 42300 dated April 11, 1997, where it was ruled, thus:

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"It is important to point here that on 8 March 1995, petitioner (Commissioner of Internal Revenue) issued BIR Ruling No. 52-95 revoking the very RMC 39-92 it used as a basis for denying respondent's claim for refund. In said ruling, the BIR said that royalties paid to an American licensor was subject only to 10% withholding tax pursuant to Article 13(2)(iii) of the RP-US Tax Treaty in relation to the RP-West Germany Tax Treaty following the ruling in the case of IBM Phil., Inc. vs. CIR, *supra*:

> "Based on the foregoing representations, you are now requesting for a ruling that your company be similarly allowed to avail of the benefits in Art. 13(2)(iii) of the RP-US Tax Treaty for the royalties payable to your US franchisor, Guess?, Inc. (U.S.A.), by applying the 10% tax rate.
>
> In reply, please be informed that your request is hereby granted. Under the most favored nation provision of the RP-US Tax Treaty, [Article 13, paragraph 2 (b)(iii) the tax imposable on royalties derived by a resident of the United States from sources within the Philippines shall be the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state. Article 12, paragraph (2)(b) of the RP-West Germany Tax Treaty, effective January 1, 1995, provides that royalties arising in the Philippines and paid to a resident of West Germany may also be taxed in the Philippines, but the tax so charged shall not exceed 10% of the gross amount of royalties arising form the use of; or the right to use any patent, trademark, design or model, plan, secret formula, or process, or from the use of. or the right to use industrial, commercial or scientific experience. The said treaty also provides that "for as

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long as the transfer of technology under Philippine law; is subject to approval, the limitation of the tax rate mentioned under (b) shall, in the case of royalties arising in the Republic of the Philippines, only apply if the contract giving rise to such royalties have been approved by the Philippine competent authorities.

Such being the case, and inasmuch as the licensing agreement between you and Guess?, Inc. (USA) has been approved by the Transfer Technology Board of the Department of Trade and Industry, royalties arising in the Philippines tax at the rate of 10% because this rate appears in the RP-West Germany tax Treaty and pursuant to Article 13, paragraph 2(b)(iii) of the RP-US Tax Treaty. The said tax shall be withheld and paid in the same manner and subject to the same conditions so provided in Section 50(a) of the Tax Code, as amended. (BIR Ruling No. 359087 dated November 13, 1987.)"

This ruling revokes BIR Ruling No. 003-93 dated January 14, 1993 in view of the Decision of the Court of Tax in the case of IBM Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308 dated July 21, 1993.)"

We do not see any reason why said ruling cannot be applied to the case at bench especially so when the BIR recognizes the settled doctrine enunciated in the IBM case.

Petitioner (Commissioner of Internal Revenue) cannot revoke the "most favored nation" clause in one instance and apply the same in another. This is in violation of the equal protection clause of the Constitution."

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As regards the second issue, this Court finds that petitioner, has clearly and satisfactorily presented the documentary and testimonial proofs required in the establishment of its claim for refund (Exhibits "B" to "BG" inclusive).

WHEREFORE, in view of the foregoing, the instant Petition for Review is hereby **GRANTED**. Accordingly, respondent is **ORDERED** to **ISSUE** a **TAX CREDIT CERTIFICATE** in the amount of P4,471,863.90 in favor of the petitioner.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
Associate Judge

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CERTIFICATION

I hereby certify that this decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals

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